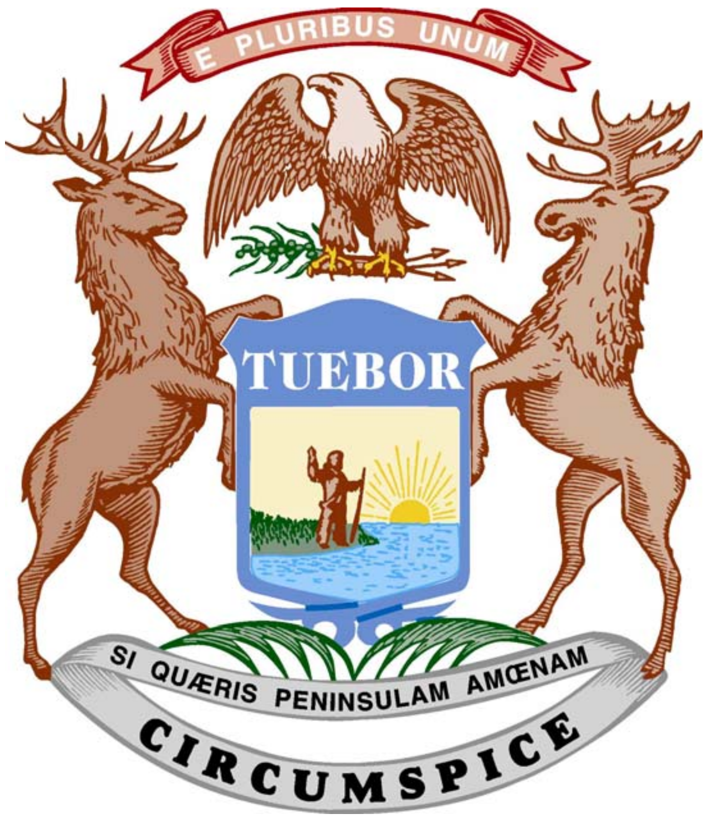
Administration Estimates Michigan Economic and Revenue Outlook



FY 2004-05 and FY 2005-06

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August 17, 2005

Table of Contents

List of Tables

ADMINISTRATION ESTIMATES
EXECUTIVE SUMMARY
August 17, 2005

Revenue Review and Outlook

- FY 2004 GF-GP revenue increased to $8,041.8 million, a 1.0 percent increase over FY 2003. School Aid Fund (SAF) revenue fell 0.9 percent to $10,615.5 million. The change in the timing of the state education tax payments increased FY 2003 SAF revenues, and as a result reduced the FY 2004 SAF growth rate. Excluding revenues related to the state education tax shift, FY 2004 SAF revenues were 3.4 percent higher than FY 2003.
- FY 2005 GF-GP revenue is projected to decline 0.9 percent to $7,967.5 million. This total is $52.8 million above the May 2005 Consensus estimate. SAF revenue is projected to increase 2.1 percent to $10,837.4 million, $13.0 million less than the May 2005 Consensus estimate.
- FY 2006 GF-GP revenue is forecast to increase 2.6 percent to $8,174.7 million. This total is up $39.6 million from the May 2005 Consensus estimate and represents a $207.2 million increase over the FY 2005 total. FY 2006 SAF revenue is forecast to grow 3.7 percent to $11,236.1 million. This represents a decline of $8.0 million from the May 2005 Consensus estimate and an increase of $398.7 million over the FY 2005 level.

2005 and 2006 U.S. Economic Outlook

- Real gross domestic product growth is forecast to average 3.6 percent in 2005 and 2.9 percent in 2006, after increasing by 4.2 percent in 2004.
- Employment is projected to continue growing over the forecast horizon. The U.S. unemployment rate is forecast to average 5.1 percent in both 2005 and 2006.
- Historically low interest rates have provided consumers with the ability to purchase housing at record levels and refinance existing mortgages. However, with wage and commodity price pressures building, interest rates are projected to increase throughout the forecast period.
- Light vehicle sales are forecast to be 17.1 million units in 2005 and 16.8 million units in 2006.
- Consumer price inflation is forecast to average 3.1 percent in 2005 and 3.0 percent in 2006.

2005 and 2006 Michigan Economic Outlook

- Michigan wage and salary employment is forecast to grow modestly throughout the forecast period. In 2005, Michigan wage and salary employment is forecast to fall 0.3 percent before increasing 0.5 percent in 2006.
- In 2005, the Michigan unemployment rate is forecast to rise to 7.2 percent in 2005 before rising to 7.5 percent in 2006.
- Wage and salaries income is forecast to increase 4.5 percent in CY 2005 and 4.1 percent in CY 2006. Personal income will post moderate increases throughout the forecast horizon. In 2005 and 2006, personal income is forecast to rise 4.6 percent and 5.6 percent, respectively.
- In FY 2005 and FY 2006, Michigan wage and salary income is expected to grow 4.1 percent and 4.0 percent. Disposable income is expected to rise 3.4 percent and 4.7 percent in FY 2005 and FY 2006, respectively.

Forecast Risks

Geopolitical concerns or a major supply disruption could raise oil prices well above the baseline forecast projections. This, in turn, would slow domestic demand more than forecasted.

If international confidence in the dollar declines dramatically, the value of the dollar may fall sharply. A plummeting dollar could roil financial markets, sharply curtailing both consumption and investment and thus slow economic growth sharply.

Firms' increased pricing power, increased obsolescence of current capacity, higher commodity prices, and rising health care and pension costs may lead to higher inflation than the baseline forecast projects. This higher inflation rate may crimp consumption and investment spending – especially if accompanied by even more aggressive inflation fighting on the part of the Federal Reserve.

A sharp decline in investor confidence in the long-term bond market would sharply decrease bond prices and sharply increase longer-term interest rates (which move in the opposite direction as bond prices). A spike in long-term interest rates would slow the housing sector, a major growth engine in the current economic economy, as well as consumption and investment growth in general. Thus, sharply higher long-term rates would severely curtail overall economic growth.

A flattening, or still more an outright decline in home prices would severely slow economic growth. Further, if a national housing bubble does exist and it bursts over the forecast horizon, there is a chance that the U.S. economy could slow sharply. Coupled with other risks materializing such as sharply higher oil prices and a rapidly declining dollar, a collapsing housing market could send the U.S. economy into recession.

ECONOMIC REVIEW AND OUTLOOK
August 17, 2005

Current U.S. Economic Situation

Summary

Over the first half of 2005, real GDP grew at a 3.6 annual rate. Real GDP grew at a 3.4 percent annual rate in the second quarter of this year, marking the ninth straight quarter in which real GDP growth exceeded 3.0 percent. Real final demand, which excludes the impact of inventory changes, grew at a 5.8 percent annual rate in the first quarter. Slowed by higher gasoline prices, real consumption growth slowed to a 3.4 percent annual rate in the first half of 2005, down from 4.4 percent in the second half of 2004. Real durable consumption growth slowed from 8.1 percent to 5.4 percent. Nonresidential fixed investment growth slowed from 11.1 percent in the second half of 2004 to 7.3 percent in the first half of 2005, while residential fixed investment growth accelerated sharply, increasing from 2.1 percent to 9.6 percent. Over this time, export growth accelerated while import growth slowed. As a result, the trade deficit (imports less exports) improved somewhat. Compared to the second half of 2004, inventories increased by half as much in the first quarter of 2005 with inventories declining in the second quarter of 2005.

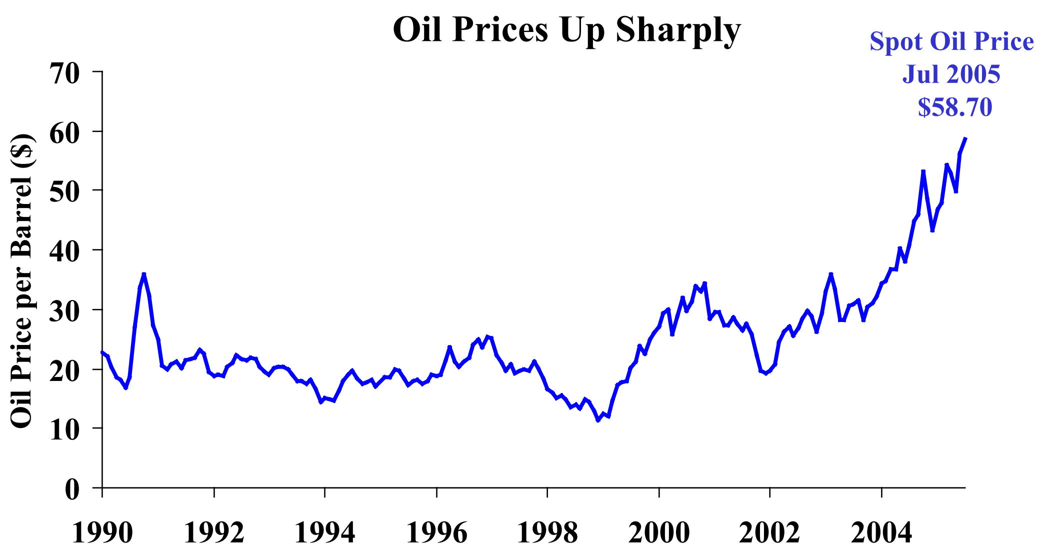
In the first half of this year, real government spending has grown at a 1.9 percent annual rate. Federal government spending grew at a 1.8 percent rate while state and local government spending rose at a 2.0 percent pace.

In the first half of 2005, the light vehicle sales rate declined slightly, falling from a 17.1 million unit rate to a 16.9 million unit rate. However, light vehicle sales rose between the first and second quarters of this year, rising from 16.5 million units to 17.2 million units.

Employment has increased each month since mid 2003. Over the past five quarters, payroll employment has increased by an average of 580,000 jobs. Over the first seven months of 2005, employment has risen by an average of 191,000 jobs per month. Monthly U.S. employment now exceeds its pre-recession peak by 1.2 million jobs. However, manufacturing employment, which peaked in March 1998, remains well below that peak – down by nearly one-fifth.

Beginning in June 2004, the Federal Reserve Open Market Committee has increased the target federal funds rate 25 basis points at each of its meetings. At its August 2005 meeting, the Committee raised the target rate for the tenth time, increasing the rate to 3.50 percent. In response to the Committee's actions, short-term rates have risen but nonetheless remain at historically low levels. Long-term rates have actually fallen since the Committee began increasing the target federal funds rate. In the past year, the 90-day Treasury bill rate has risen 1.72 percentage points while the 10 year Treasury bond rate has declined 0.73 percentage points. The Aaa corporate bond rate has declined 1.05 percentage points. In recent weeks, long-term rates have hooked upward.

After falling slightly below $50 a barrel in May, average monthly oil prices rose sharply in June. In July, oil prices averaged $58.70. In recent weeks, oil prices have risen above $60 a barrel. Oil prices are up nearly 50 percent from a year ago.



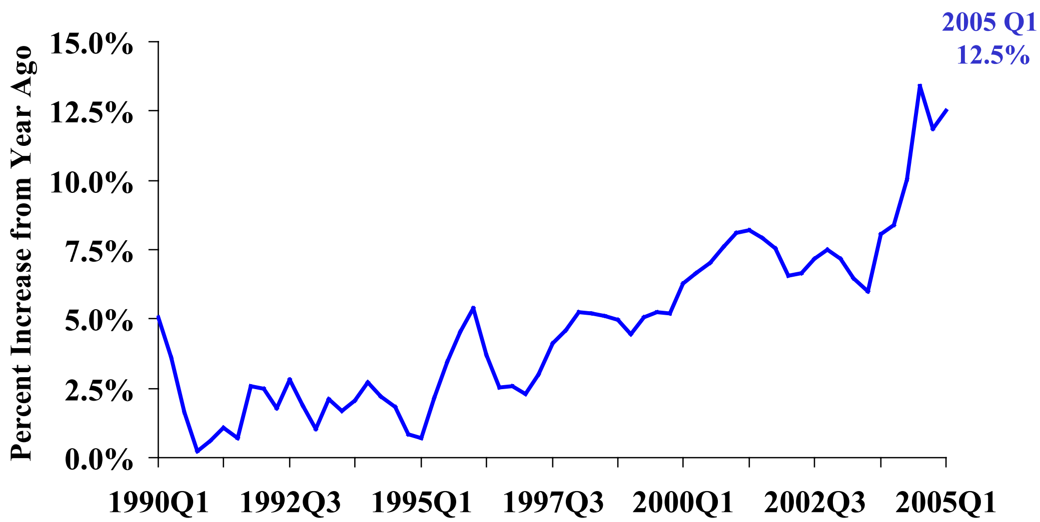
Sources: Federal Reserve Bank of St. Louis.

The news on inflation has been mixed. In the July 2005 Beige Book, the Federal Reserve reported, "Despite generally tighter labor markets, nearly all Districts said overall wage pressures remained moderate". In addition, unit labor costs grew at an annual rate of 1.3% in the second quarter, the slowest increase in a year. At the same time, the ISM non-manufacturing prices index rose sharply in July to its highest level this year. In July, average hourly earnings gained 0.4%, the biggest rise in a year. Productivity growth slowed in the second quarter and is likely to continue to slow – boosting inflationary pressures. Finally, the Bureau of Economic Analysis' July revisions show that the Federal Reserve's favored price measure, the price index for personal consumption expenditures minus energy and food, now indicates that inflation was notably higher last year than previously thought, 2.2% instead of 1.6%. Coupled with high and rising oil prices, inflationary pressures appear to be building.

Fueled by low mortgage rates, increasingly more creative financing, and speculative buying, the U.S. housing market continues to be strong. Through the first six months of this year, housing starts have averaged an astounding 2.0 million units annual rate. Both existing and new home sales rose to new record levels in June 2005.

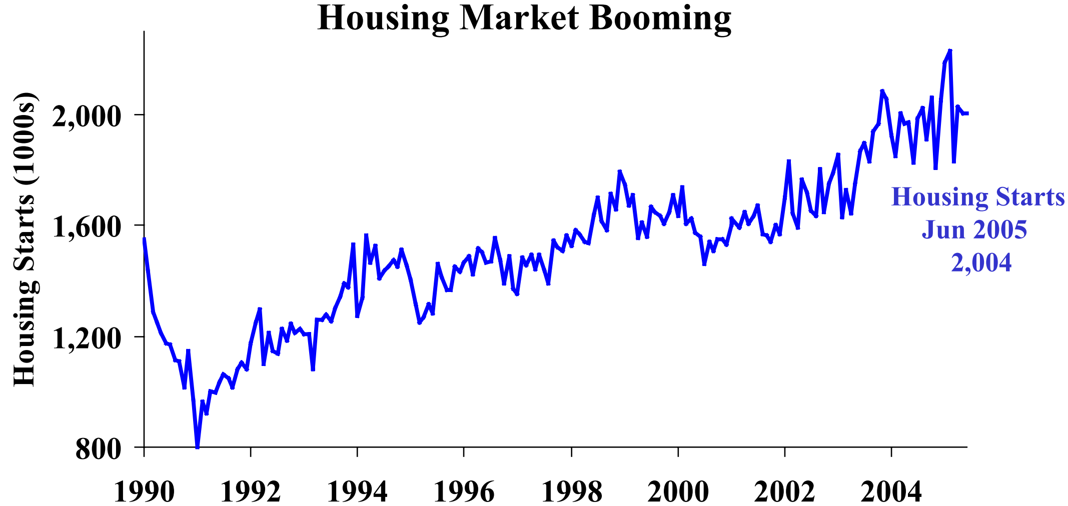
The Office of Federal Housing Enterprise Oversight (OFHEO) reported that average U.S. home prices were up 12.5 percent in the first quarter of 2005 compared to a year ago. Prices in the first quarter grew at an 8.8 percent annual rate. OFHEO's chief economist noted that, "The House Price Index shows the rise in house prices continues at an extremely strong pace and raises the potential for declines in some areas later on." Indeed, this *asset* inflation, representing likely excesses in the housing market, may provide the Federal Reserve another reason for continuing to raise interest rates. The Federal Reserve may seek to stem continued rapid price increases in order to avert a more serious problem later. Some have expressed concern that the national housing market (not just isolated housing markets) is already experiencing a housing bubble. A possible collapse in the housing market represents a very serious downside risk to the baseline forecast. In recent weeks, there is anecdotal evidence that the housing market may be cooling.

Housing Prices Spike



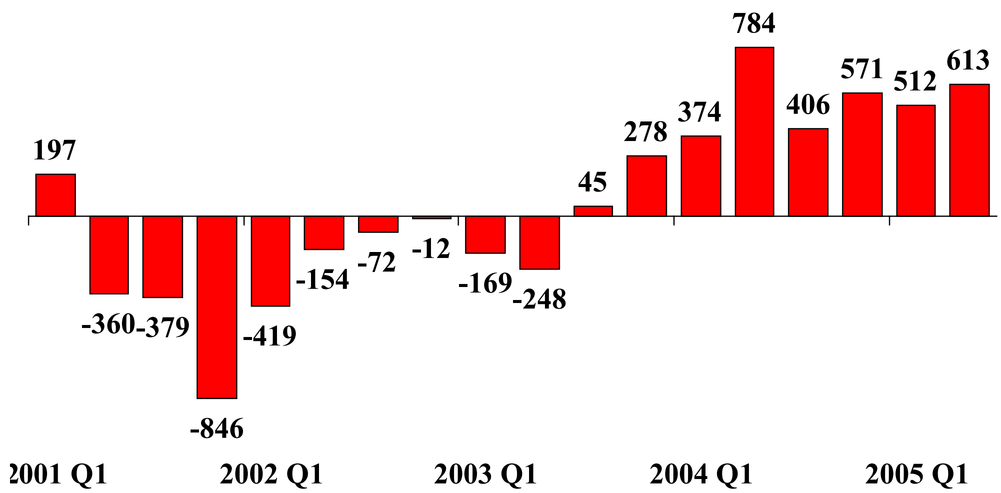
Sources: Office of Federal Housing Enterprise Oversight

Housing Market Booming



Source: U.S. Department of Commerce, Bureau of the Census.

US Payroll Employment Growing
(Quarterly Change in Thousands)

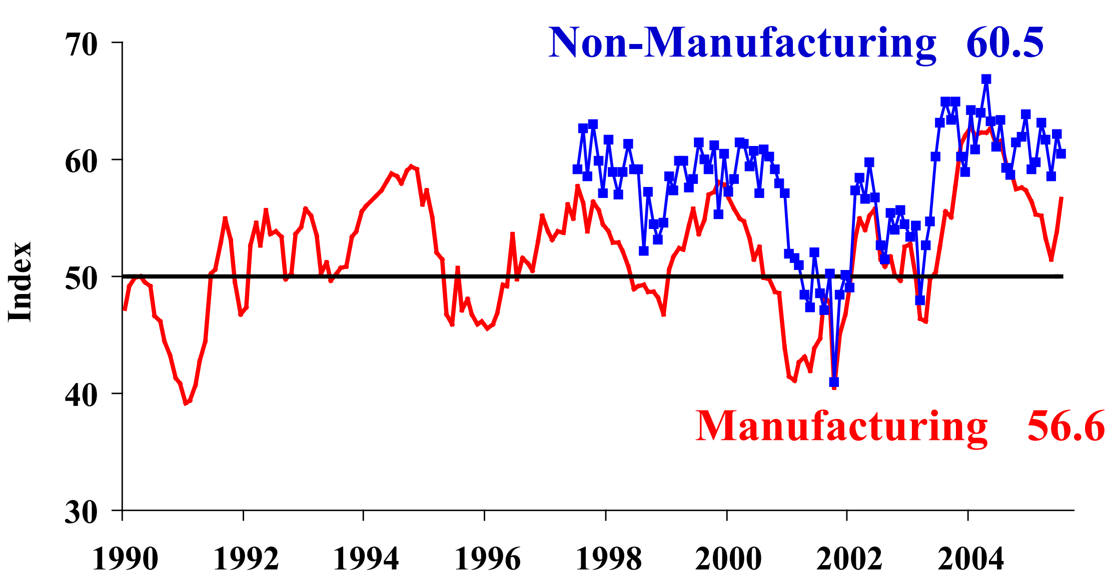


Source: U.S. Bureau of Labor Statistics

<u>Major Economic Indicators</u>

Major U.S. economic indicators point to continued, but likely slowing, economic growth. After declining each month between December 2004 and May 2005, the Institute for Supply Management's (ISM) manufacturing index has risen the past two months. The index has signaled growth in the manufacturing sector each month since mid-2003. The non-manufacturing index has signaled growth each month since April 2003. The non-manufacturing index has been above 60 in four of the past five months. A reading above 50 indicates a growing sector.

ISM Indices Signal Growth in Manufacturing and Services



Source: Institute for Supply Management.

For two years, new orders for durable goods have trended upward. After declining the first three months of the year, new orders increased each month between April and June. In June, new orders rose to their highest level in five years. Compared to a year ago, orders are up 12.4 percent. Industrial production has increased 3.9 percent over the past year.

June 2005 retail sales are up 9.6 percent, fueled by surging light vehicle sales. After declining for five straight months, consumer sentiment rose sharply in June before flattening out in July. The ABC News/Washington Post consumer comfort index, which measures consumers' attitude toward current economic conditions, has move sideways over the past few months.

In June, the index of leading economic indicators rose sharply after having been flat in May.

Employment

U.S. employment has now increased every month since June 2003. Over the first seven months of this year, employment has increased by 191,000 jobs per month. In July, employment rose by 207,000 jobs. Over the past year, employment is up by 2.2 million jobs (1.7 percent). With these gains, U.S. employment is now 1.2 million jobs above its pre-recession peak.

However, manufacturing employment remains hard hit. In July, manufacturing employment was 3.4 million jobs (19.1 percent) below its 1998 pre-recession peak. Over the past year, while overall employment has increased, manufacturing employment has been flat. Further, July employment in the motor vehicle and parts sector was down 1.6 percent from a year ago. Compared to its 2000 pre-recession peak, motor vehicle and parts employment is down 19.2 percent. Rapid productivity gains allowed firms to reduce payroll employment even as they continued to increase output. Compared to a year ago, initial unemployment claims have fallen from around 340,000 to around 320,000 (four week moving average).

After having shown expansion each month between November 2003 and April 2005, the Institute for Supply Management's (ISM) manufacturing employment index component indicated contracting employment in May and June. The index again showed employment expansion in July. The non-manufacturing ISM employment index has signaled expansion each month since October 2003. After declining in March and April, the index component increased in May and June before declining in July. In July, the Challenger report count of announced layoffs remained above 100,000 for a second straight month. Announced layoffs rose sharply in May and June before declining slightly in July. July announced layoffs were 48 percent higher than a year ago.

In July, the average workweek, a leading indicator for employment, remained unchanged for the second straight month at 33.7 hours. Compared to a year ago, the average workweek is unchanged.

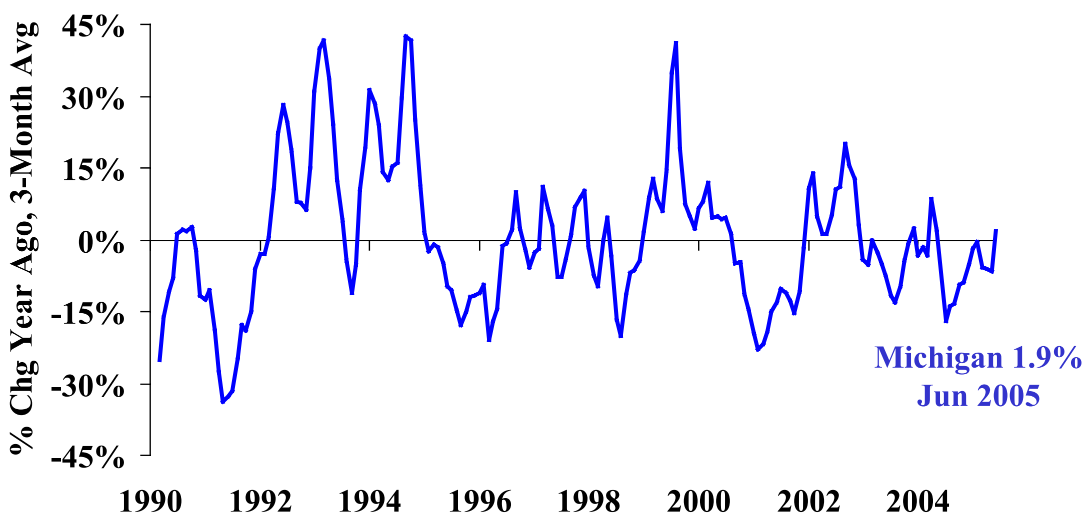
Vehicle Sales and Production

After falling to their lowest level since mid 2003 in the first quarter, light vehicle sales rose to a 17.2 million unit rate in the second quarter. In June, General Motors began offering employee pricing for everyone. Chrysler and Ford followed suit in July. As a result, July vehicle sales surged above a 20.0 million unit rate, the highest monthly rate since October 2001 when GM introduced zero percent financing. Employee pricing has been extended into August. The promotion's impact has been significant. Richard Curtin, University of Michigan, noted that in the Survey of Consumers, "An all-time record proportion of consumers specifically mentioned vehicle price discounts in July."

Over the past few years, imports and transplants have continued to increase their market share. The traditional Big Three market share has continued to fall, with their share at 58.7 percent for 2004, a record low.

Averaged over the past three months, U.S. vehicle production in June 2005 was up 1.9 percent in Michigan, compared with a 0.5 percent decline nationally.

Michigan Vehicle Production Up from Year Ago



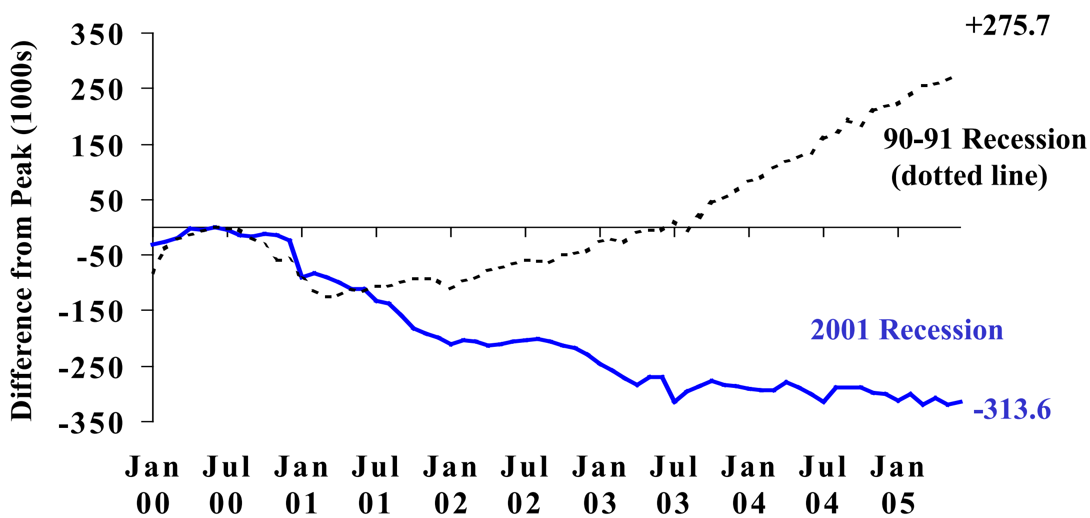
Source: Michigan Department of Treasury and Automotive News.

Current Michigan Economic Conditions

Employment

Michigan's economy relies heavily on the performance of the manufacturing sector in general and the auto industry specifically. Given extremely weak manufacturing employment performance, declining vehicle production, continued declines in Big 3 market share along with continued supply rationalization among vehicle suppliers, Michigan's employment performance has been below the national average. Substantial productivity gains in the vehicle industry have also contributed to Michigan's sub-par employment performance. Over the past four years, the annual average for wage and salary employment has fallen. However, these declines have slowed across time. From Michigan's employment peak in June 2000 compared to June 2005, Michigan has lost 313,600 jobs. By this time after the 1990-1991 recession, Michigan employment had risen by about 275,000 jobs *above* its pre-recession peak.

Michigan Has Lost Over 300,000 Jobs Since June 2000



Source: Bureau of Labor Statistics.

Michigan manufacturing employment has declined even more sharply. Since June 2000, Michigan manufacturing employment has fallen by 234,300. Michigan has lost one out of every four manufacturing jobs it had at the state's employment peak.

Unemployment Rate

Michigan's annual average unemployment rate for 2004 is 7.1 percent, matching the state's 2003 unemployment rate. After rising to 7.1 percent in May, the state's unemployment rate fell to 6.8 percent in June, it lowest level in over a year.

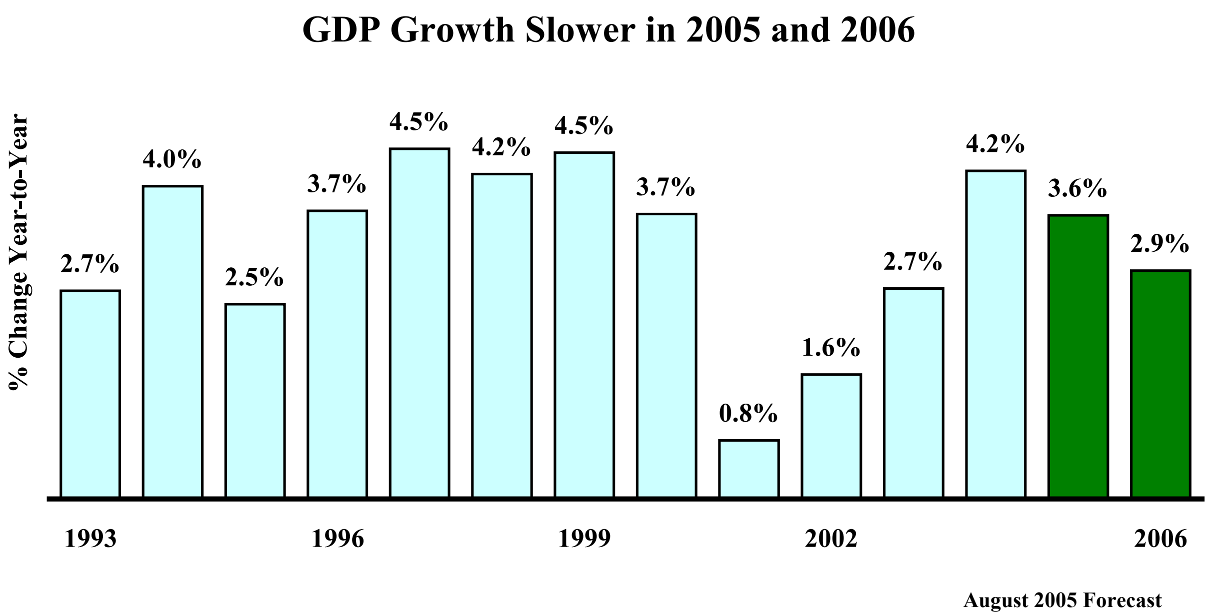
Personal Income

Based on preliminary estimates, Michigan's personal income rose 2.6 percent in 2004; wages and salaries grew 1.9 percent. Overall personal income grew 4.9 percent in the first quarter of 2005 compared with 6.8 percent growth nationally.

2005 and 2006 U.S. Economic Outlook

Summary

Real GDP growth is forecast to slow from 4.2 percent growth in 2004 to 3.6 percent growth in 2005 and 2.9 percent growth in 2006. Highly indebted consumers are expected to retrench their spending somewhat, helping to slow growth.



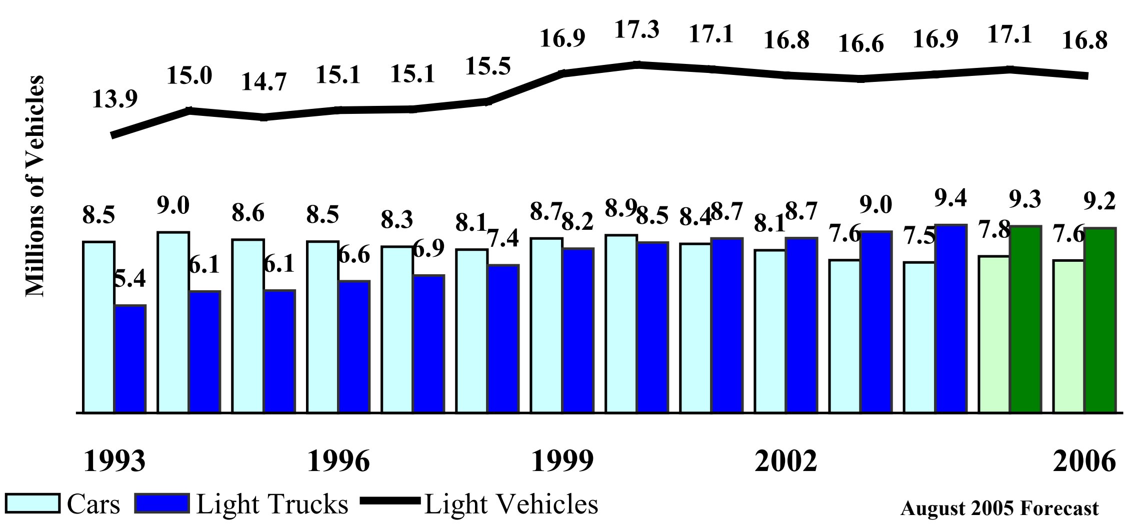
Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, August 2005.

Light vehicle sales are projected to remain relatively stable with projected sales of 17.1 million units in 2005 and 16.8 million units in 2006.

As measured by the consumer price index (CPI), consumer prices are expected to rise 3.1 percent in 2005 and 3.0 percent in 2006. Interest rates are forecast to rise as the Federal Reserve continues to raise the target federal funds rate. Between 2004 and 2006, the 3-month Treasury bill rate is forecast to increase from 1.4 percent to 4.5 percent while the Aaa corporate bond rate rises, but less so, increasing from 5.6 percent to 6.5 percent.

U.S. employment is forecast to rise in 2005 and 2006 with gains projected throughout the forecast horizon. The U.S. unemployment rate is expected to fall from 5.5 percent in 2004 to 5.1 percent in both 2005 and 2006.

Motor Vehicle Sales Stable



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, August 2005.

Assumptions

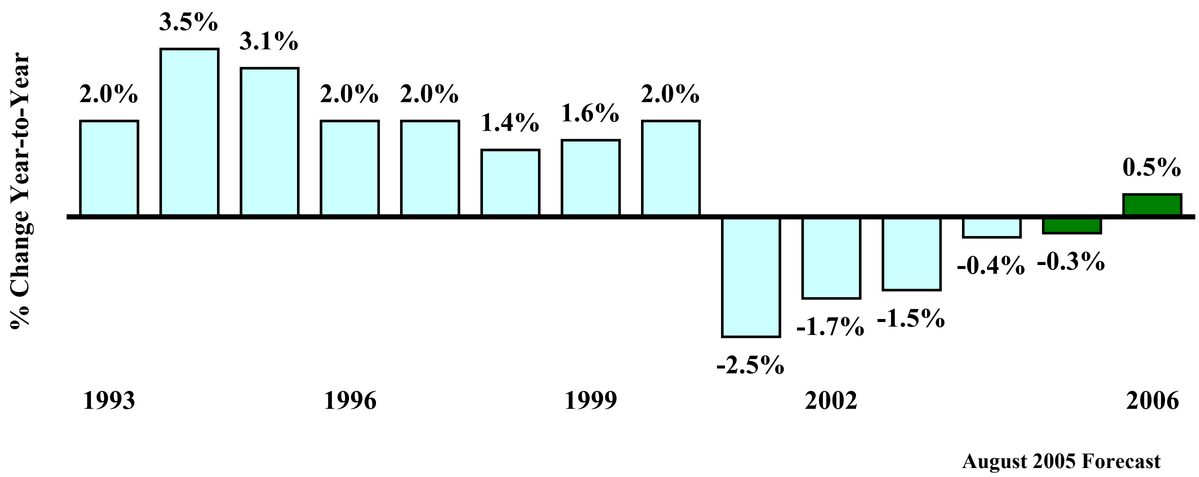
Oil prices are projected to remain just under $60 a barrel through early 2006 before rising slightly. By the end of 2006, oil prices are expected to fall to just over $50 a barrel. With continued commodity price pressures and concerns about a frothy housing market, the Federal Reserve is assumed to continue to raise the target federal funds rate through mid-2006. The target federal funds rate is projected to rise to 4.25 percent by the end of 2005 and 5.00 percent by mid 2006 at which time the Federal Reserve is expected to leave the target rate unchanged over the balance of the forecast horizon.

The household savings rate is forecast to remain well below 1.0 percent through the end of 2005. The savings rate is then projected to rise gradually, rising to 1.0 percent by the end of 2006. Stock prices are expected to remain flat through the end of 2005 and then rise very modestly in 2006.

2005 and 2006 Michigan Economic Outlook

Michigan employment is forecast to decline slightly in 2005, marking the fifth straight year in which state employment declined. Employment is then expected to increase 0.5 percent in 2006. Continued declines in manufacturing employment will constrain overall Michigan employment. In 2005, employment is forecast to decline an average of 2,000 jobs per quarter and increase an average of 6,000 per quarter in 2006. Michigan's unemployment rate is forecast to rise in 2005 to 7.2 percent before increasing to 7.5 percent in 2006.

Michigan Wage and Salary Employment Grows in 2006



Source: Michigan Department of Labor and Economic Growth, U.S. Bureau of Labor Statistics and Administration Forecast, August 2005.

Wage and salary income is projected to rise 4.5 percent in 2005. In 2006, wage and salary income is projected to increase 4.1 percent as employment increases. Michigan personal income is forecast to rise 4.6 percent in 2005 and 5.6 percent in 2006.

Inflation, as measured by the Detroit CPI, is forecast to rise 2.6 percent in 2005 and 2.6 percent in 2006. As a result, real Michigan personal income (inflation adjusted) is expected to rise 2.0 percent in 2005 and 2.9 percent in 2006.

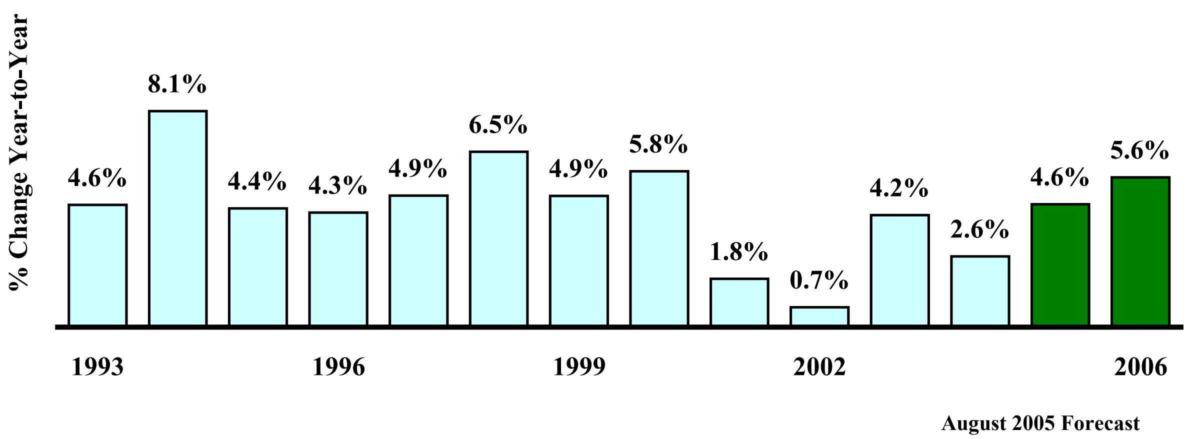
Table 1

Adminstration Economic Forecast

August 2005

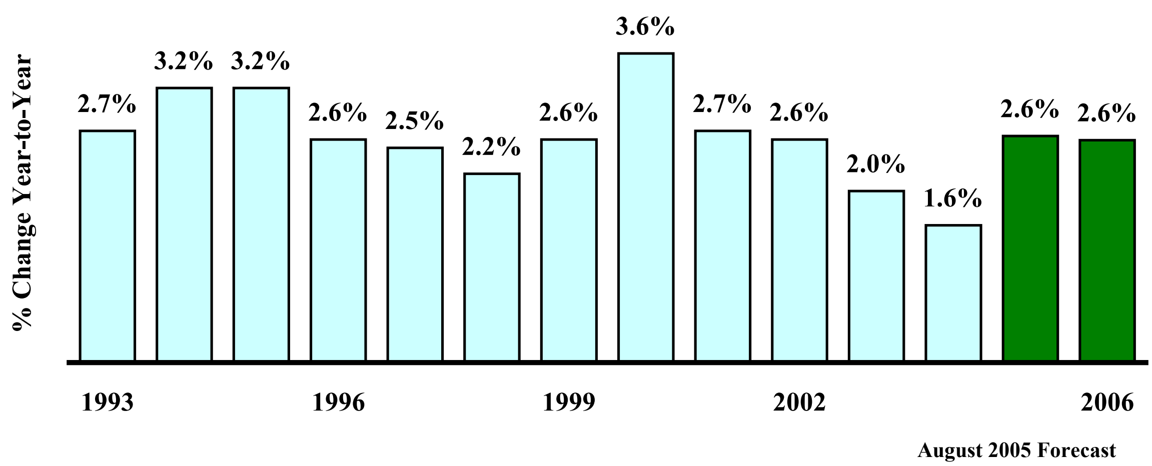
	Calendar 2003 Actual	Calendar 2004 Forecast	Percent Change from Prior Year	Calendar 2005 Forecast	Percent Change from Prior Year	Calendar 2006 Forecast	Percent Change from Prior Year
United States							
Real Gross Domestic Product (Billions of Chained 2000 Dollars)	$10,321	$10,756	4.2%	$11,148	3.6%	$11,475	2.9%
Implicit Price Deflator GDP (2000 = 100)	106.3	109.1	2.6%	111.8	2.5%	114.9	2.8%
Consumer Price Index (1982-84 = 100)	184.0	189.0	2.7%	194.9	3.1%	200.7	3.0%
Personal Consumption Deflator (2000 = 100)	105.5	108.2	2.6%	110.9	2.5%	113.7	2.5%
3-month Treasury Bills Interest Rate (percent)	1.0	1.4		3.2		4.5	
Aaa Corporate Bonds Interest Rate (percent)	5.7	5.6		5.7		6.5	
Unemployment Rate - Civilian (percent)	6.0	5.5		5.1		5.1	
Light Vehicle Sales (millions of units)	16.6	16.9	1.3%	17.1	1.4%	16.8	-1.8%
Passenger Car Sales (millions of units)	7.6	7.5	-1.4%	7.8	3.9%	7.6	-2.6%
Light Truck Sales (millions of units)	9.0	9.4	3.7%	9.3	-0.7%	9.2	-1.1%
Import Share of Light Vehicles (percent)	19.9	20.2		20.7		21.5	
Michigan							
Wage and Salary Employment (thousands)	4,410	4,391	-0.4%	4,376	-0.3%	4,397	0.5%
Unemployment Rate (percent)	7.1	7.1		7.2		7.5	
Personal Income (millions of dollars)	$314,346	$322,636	2.6%	$337,419	4.6%	$356,269	5.6%
Real Personal Income (millions of 1982-84 dollars)	$172,244	$173,816	0.9%	$177,309	2.0%	$182,515	2.9%
Wages and Salaries (millions of dollars)	$176,646	$180,007	1.9%	$188,059	4.5%	$195,813	4.1%
Detroit Consumer Price Index (1982-84 = 100)	182.5	185.4	1.6%	190.3	2.6%	195.2	2.6%
Detroit CPI Fiscal Year (1982-84 = 100)	182.0	184.4	1.3%	189.0	2.5%	194.4	2.8%

Michigan Personal Income Growth Stronger in 2006



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, August 2005.

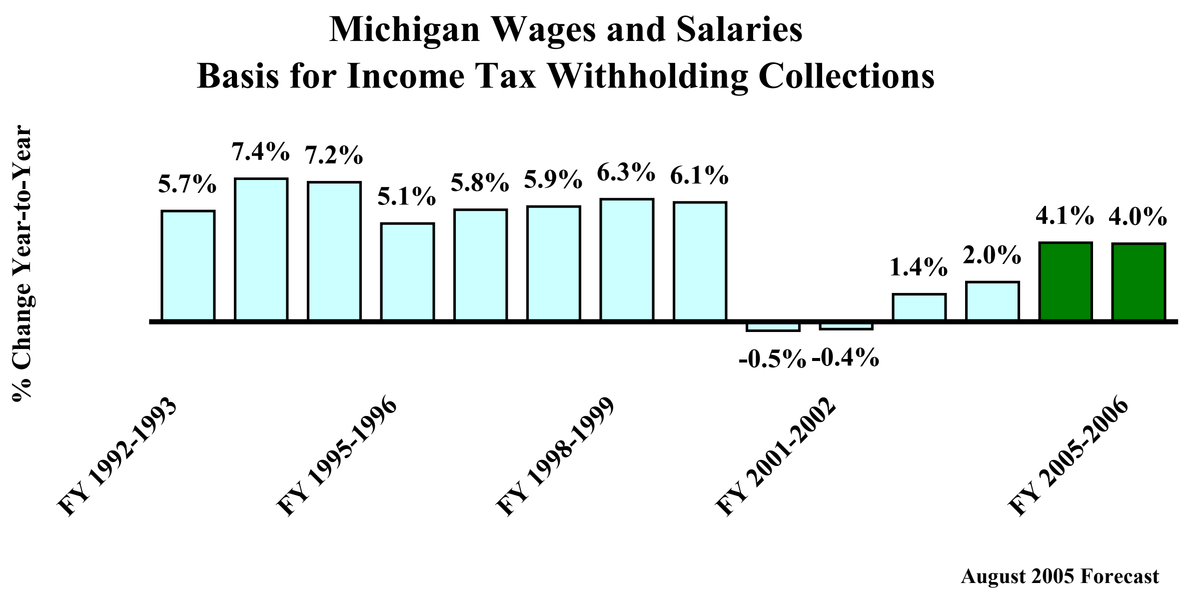
Inflation Rate Increases
Detroit CPI



Source: U.S. Bureau of Labor Statistics and Administration Forecast, August 2005.

Fiscal Year Economics

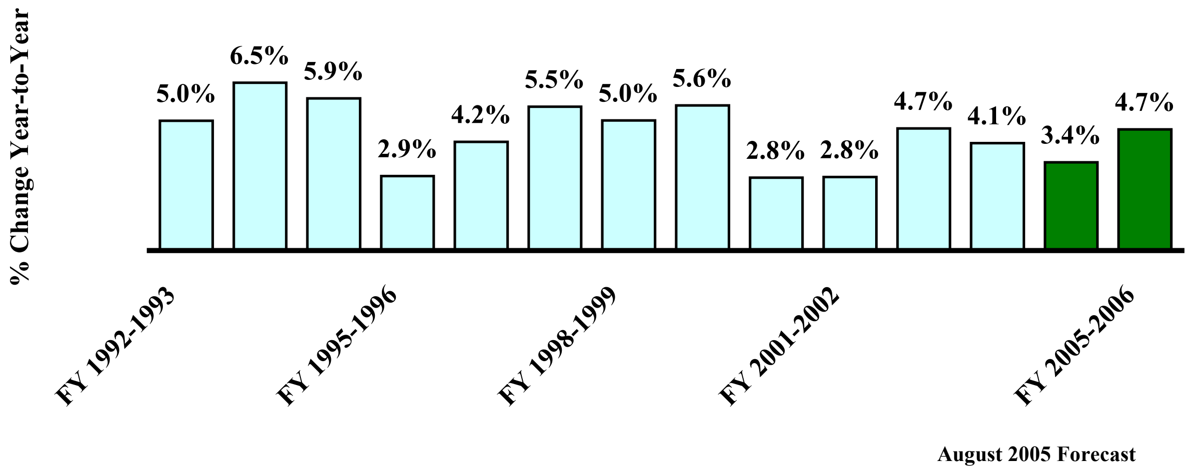
Michigan's largest taxes are the individual income tax, which includes refunds, ($6.1 billion) and sales and use taxes ($8.4 billion). Income tax withholding is the largest income tax component. Withholding ($6.6 billion) is most affected by growth in wages and salaries. Michigan wages and salaries are expected to grow 4.1 percent in FY 2005 and to grow 4.0 percent in FY 2006.



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, August 2005.

Sales and use taxes depend primarily on Michigan disposable (after tax) income and inflation. Disposable income is expected to rise 3.4 percent in FY 2005 and to increase 4.7 percent in FY 2006. The inflation rate is forecast to rise 2.5 percent in FY 2005 and is expected to increase 2.8 percent in FY 2006.

Michigan Disposable Income
Basis for Sales and Use Tax Collections



Source: Research Seminar in Quantitative Economics, University of Michigan, and Administration Forecast, August 2005.

Forecast Risks

The baseline forecast assumes that the price of a barrel of oil will remain in the upper to mid $50s through most of the forecast horizon. Geopolitical concerns, increased demand or a major supply disruption could raise prices well above this assumed level. At the same time, recent high oil prices may slow the world economy leading to a reduction in the demand for oil and its price. A higher (lower) oil price will help retard/elevate domestic growth.

The baseline forecast assumes that the value of the dollar will continue to fall in an orderly fashion. However, if international confidence in the dollar declines dramatically, the value of the dollar may fall sharply. A plummeting dollar could roil financial markets, sharply curtailing both consumption and investment and thus slow economic growth sharply. A collapsing dollar would also put upward pressure on inflation and possibly lead to still higher interest rates, which would further retard growth.

Firms' increased pricing power, increased obsolescence of current capacity, higher commodity prices, and rising health care and pension costs may lead to higher inflation than the baseline forecast projects. This higher inflation rate may crimp consumption and investment spending – especially if accompanied by even more aggressive inflation fighting on the part of the Federal Reserve.

The forecast assumes that the manufacturing sector grows more slowly than U.S. economic growth would project. Given Michigan's manufacturing mix, it is very possible that manufacturing growth would grow substantially more slowly than U.S. economic growth itself would imply. This would retard Michigan economic growth, employment and income growth.

If business investment is above projected levels, economic growth may be more than forecast. For the Michigan economy, Big Three market share is important. Sharp declines in market share would affect the Michigan economy adversely compared to other states. Similarly, faster/slower productivity growth may decrease/increase employment. Faster/slower inventory investment will increase/decrease economic growth.

A substantial portion of current U.S. economic activity depends directly or indirectly on the strong housing market. Through refinancings, home equity loans and realization of capital gains on housing sales, rapidly appreciating home prices have provided substantial support for the overall economy. In many ways, consumers have come to rely on appreciating home prices as a source of “income.” To the extent to which home prices flatten out, or still more seriously, decline, consumption and, in turn, investment, may fall more sharply than the baseline forecast assumes.

The baseline forecast assumes that the Federal Reserve succeeds in averting a collapse of the U.S. housing market through federal funds rate increases that translate into increases in higher mortgage rates. To the extent to which the Fed is not successful in effecting an orderly correction in the housing market, a housing bubble may burst and the economy may grow substantially less slowly than the baseline forecast projects. There remains an outside chance that a collapsing housing market, combined with other risk factors, could send the U.S. economy into recession.

As noted earlier, long-term interest rates have actually declined even in the face of rising short-term interest rates. Interest rates (which move in the opposite direction of bond prices) have remained low because bond prices have remained relatively high. To the extent to which investors less and less regard bonds as attractive investments, bond prices could fall sharply and thus interest rates could rise sharply. A sharp rise in interest rates would adversely impact the housing market, whose strength is greatly dependent upon low mortgage rates.

The forecast assumes that the large rise in vehicle sales due to the employee pricing promotion will not translate into a sizeable decline in sales following the promotion. However, to the extent to which the high sales are the result of future sales being pulled forward, vehicle sales will be weaker than forecast. Weaker vehicle sales would translate into a reduction in vehicle production and a slowing of overall economic growth.

ADMINISTRATION REVENUE ESTIMATES
August 17, 2005

Revenue Estimate Overview

The revenue estimates presented in this section consist of baseline revenues, revenue adjustments, and net revenues. Baseline revenues provide an estimate of the effects of the economy on tax revenues. For these estimates, FY 2004 is the base year. Any non-economic changes to the taxes occurring in FY 2005 and FY 2006 are not included in the baseline estimates. Non-economic changes are referred to in the tables as "tax adjustments." The net revenue estimates are the baseline revenues adjusted for tax adjustments.

This treatment of revenue is best illustrated with an example. Suppose tax revenues are $10.0 billion in a given year, and that based on the economic forecast, revenues are expected to grow by 5.0 percent per year. Baseline revenue would be $10.0 billion in Year 1, $10.5 billion in Year 2, and $11.0 billion in Year 3. Assume a rate cut is in place that would reduce revenues by $100 million in Year 1, $200 million in Year 2, and $300 million in Year 3. If Year 1 is the base year, the revenue adjustments for Year 1 would be $0 since the tax cut for this year is included in the base. The revenue adjustments for Year 2 would be $100 million, and the revenue adjustments for Year 3 would be $200 million, since the revenue adjustments are compared to the base year.

In the example above, the baseline revenues would be $10.0 billion, $10.5 billion, and $11.0 billion, for Years 1 through 3, respectively. The revenue adjustments would be $0 in Year 1, $100 million in Year 2, and $200 million in Year 3. The $200 million in Year 3 represents the tax cuts since Year 1. Net revenue would be $10.0 billion in Year 1, $10.4 billion in Year 2, and $10.8 billion in Year 3.

The revenue figures presented below are on a Consensus basis. Generally speaking, the Consensus estimates do not include certain one-time budget measures, such as withdrawals from the Budget Stabilization Fund, the sale of buildings, etc. The figures also assume the full statutory amount for revenue sharing payments. In addition, the estimates only include enacted legislation and do not include the effects of any proposed changes. The School Aid Fund estimates consist of taxes plus the transfer from the State Lottery Fund.

FY 2004 Revenue Review

FY 2004 GF-GP revenue totaled $8,041.8 million on a Consensus basis, a 1.0 percent increase over FY 2003. This was the first increase in GF-GP revenues since FY 2000. SAF revenue totaled $10,615.5 million, a 0.9 percent decline compared to FY 2003 (See Table 2). The change in the timing of the state education tax payments increased FY 2003 SAF revenues, and as a result reduced the FY 2004 SAF growth rate. Excluding revenues related to the state education tax shift, FY 2004 SAF revenues were 3.4 percent higher than FY 2003.

Table 2

FY 2003-04 Administration Revenue Estimates

(millions)

	Actual	
	Amount	**Growth**
General Fund - General Purpose		
Baseline Revenue	$7,992.6	
Tax Cut Adjustments	$49.3	
Net Resources	$8,041.8	1.0%
School Aid Fund		
Baseline Revenue	$10,533.5	
Tax Cut Adjustments	$82.0	
Net Resources	$10,615.5	-0.9%
Combined		
Baseline Revenue	$18,526.1	
Tax Cut Adjustments	$131.3	
Net Resources	$18,657.4	-0.1%

FY 2005 Revenue Outlook

FY 2005 revenue growth benefited from strong growth in annual payments for the income tax and single business tax. FY 2005 GF-GP revenue is expected to be $7,967.5 million, a 3.0 percent baseline increase, and a 0.9 percent reduction after tax adjustments. Net GF-GP growth is slowed by a number of factors including the income tax rate cut, the continued phase-out of the state's estate tax, and the shift of some tobacco revenues to the Medicaid Trust Fund. The FY 2005 estimate is $52.8 million above the May 2005 Consensus estimate. SAF revenue is forecast to be $10,837.4 million, representing 3.1 percent SAF baseline growth and 2.1 percent growth after tax adjustments. The FY 2005 SAF estimate is $13.0 million lower than the May Consensus estimate (See Table 3).

Table 3

FY 2004-05 Administration Revenue Estimates

(millions)

	Consensus May 19, 2005		Administration August 17, 2005		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue	$8,177.7	2.3%	$8,234.8	3.0%	
Tax Cut Adjustments	($263.0)		($267.3)		
Net Resources	$7,914.7	-1.6%	$7,967.5	-0.9%	$52.8
School Aid Fund					
Baseline Revenue	$10,850.7	3.0%	$10,854.7	3.1%	
Tax Cut Adjustments	($0.2)		($17.3)		
Net Resources	$10,850.5	2.2%	$10,837.4	2.1%	($13.0)
Combined					
Baseline Revenue	$19,028.4	2.7%	$19,089.5	3.0%	
Tax Cut Adjustments	($263.2)		($284.6)		
Net Resources	$18,765.2	0.6%	$18,804.9	0.8%	$39.7

FY 2006 Revenue Outlook

Revenues continue to grow in FY 2006 as the Michigan economy continues to slowly improve. FY 2006 GF-GP revenue is expected to be $8,174.7 million, a 2.2 percent baseline increase, and a 2.6 percent increase after tax adjustments. Net GF-GP growth is increased in FY 2006 by the shift of some tobacco tax revenues from the Medicaid Trust Fund back to GF-GP. The FY 2006 GF-GP estimate is $39.6 million above the May 2005 Consensus estimate. SAF revenue is forecast to be $11,236.1 million, representing 3.5 percent SAF baseline growth and 3.7 percent growth after tax adjustments. The FY 2006 SAF estimate is $8.0 million below the May 2005 Consensus estimate (see Table 4).

Table 4

FY 2005-06 Administration Revenue Estimates

(millions)

	Consensus May 19, 2005		Administration August 17, 2005		
	Amount	**Growth**	**Amount**	**Growth**	**Change**
General Fund - General Purpose					
Baseline Revenue	$8,368.3	2.3%	$8,412.6	2.2%	
Tax Cut Adjustments	($233.3)		($237.9)		
Net Resources	$8,135.0	2.8%	$8,174.7	2.6%	$39.6
School Aid Fund					
Baseline Revenue	$11,236.2	3.6%	$11,236.7	3.5%	
Tax Cut Adjustments	$7.9		($0.6)		
Net Resources	$11,244.1	3.6%	$11,236.1	3.7%	($8.0)
Combined					
Baseline Revenue	$19,604.5	3.0%	$19,649.2	2.9%	
Tax Cut Adjustments	($225.4)		($238.5)		
Net Resources	$19,379.1	3.3%	$19,410.8	3.2%	$31.7

Constitutional Revenue Limit

Article IX, Section 26, of the Michigan Constitution establishes a limit on the amount of revenue state government can collect in any given fiscal year. The revenue limit for a given fiscal year is equal to 9.49 percent of the state's personal income for the calendar year prior to the year in which the fiscal year begins. FY 2003 revenue is compared to CY 2001 personal income. If revenues exceed the limit by less than 1 percent, the state may deposit the excess into the Budget Stabilization Fund (BSF). If the revenues exceed the limit by more than 1 percent, the excess revenue is refunded to taxpayers via the income and single business taxes.

FY 2003 revenues were $4.2 billion below the revenue limit, and FY 2004 revenues were $4.4 billion below the limit. State revenues will also be well below the limit for FY 2005 and FY 2006. FY 2005 revenues are expected to be $5.2 billion below the limit, and FY 2006 revenues $5.1 billion below the limit (See Table 5).

Table 5

Administration Constitutional Revenue Limit Calculation

(millions)

	FY 2003 Actual Mar 2004	FY 2004 Actual May 2005	FY 2005 Admin Aug 2005	FY 2006 Admin Aug 2005
Revenue Subject to Limit	$24,061.6	$24,384.7	$24,620.1	$25,479.1
Revenue Limit	**CY 2001**	**CY 2002**	**CY 2003**	**CY 2004**
Personal Income	$297,609	$303,745	$314,460	$322,636
Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	$28,243.1	$28,825.4	$29,842.2	$30,618.2
Amount Under (Over) Limit	**$4,181.5**	**$4,440.7**	**$5,222.1**	**$5,139.1**

Budget Stabilization Fund Calculation

The Management and Budget Act contains provisions for calculating a recommended deposit or withdrawal from the BSF. The calculation looks at personal income net of transfer payments. The net personal income figure is adjusted for inflation. The change in this figure for the calendar year determines whether a pay-in or pay-out is dictated. If the formula calls for a deposit into the BSF, the deposit is made in the next fiscal year. If the formula calls for a withdrawal, the withdrawal is made during the current fiscal year.

If real personal income grows by more than 2 percent in a given calendar year, the fraction of income growth over 2 percent is multiplied by the current fiscal year's GF-GP revenue to determine the pay-in for the next fiscal year. If real personal income declines, the percentage deficiency under zero is multiplied by the current fiscal year's GF-GP revenue to determine the withdrawal available for the current fiscal year. If the change in real personal income is between 0 and 2 percent, no pay-in or withdrawal is indicated.

Real calendar year personal income for Michigan is expected to increase by 2.1 percent in 2005. Therefore, the formula indicates a BSF pay-in of 0.1 percent of FY 2005 GF-GP revenue ($8.0 million) in FY 2006 (See Table 6).

Table 6

Budget and Economic Stabilization Fund Calculation Based on CY 2005 Personal Income Growth Administration Calculation

		CY 2004		CY 2005
Michigan Personal Income	$	322,636 [1]	$	337,419 [2]
less Transfer Payments	$	49,101 [1]	$	51,988 [2]
Income Net of Transfers	$	273,535	$	285,431
Detroit CPI		1.837 [3]		1.878 [3]
for 12 months ending		(June 2004)		(June 2005)
Real Adjusted Michigan Personal Income	$	148,903	$	151,987
Change in Real Adjusted Personal Income				2.1%
Excess over 2%				0.1%
GF-GP Revenue Fiscal Year 2004-2005			$	7,967.5

		FY 2005-2006
BSF Pay-In Calculated for FY 2006	$	8.0

Notes:

[1] Personal Income and Transfer Payments, Bureau of Economic Analysis, June 2005.

[2] Personal Income and Transfer Payments, Administration Forecast, August 2005.

[3] Detroit Consumer Price Index, Average of 6 monthly values reported by BLS for each 12-month period.

School Aid Fund Revenue Adjustment Factor

The School Aid Fund (SAF) revenue adjustment factor for the next fiscal year is calculated by dividing the sum of current year and subsequent year SAF revenue by the sum of current year and prior year SAF revenue. For example, the FY 2006 SAF revenue adjustment factor is calculated by dividing the sum of FY 2005 and FY 2006 SAF revenue by the sum of FY 2004 and FY 2005 SAF revenue. The SAF revenue totals are adjusted for any change in the rate and base of the SAF taxes. The year for which the adjustment factor is being calculated is used as the base year for any tax adjustments. For FY 2006, the SAF revenue adjustment factor is calculated to be 1.0329 (See Table 7).

Table 7

Administration School Aid Revenue Adjustment Factor

For Fiscal Year FY 2006

	FY 2004	FY 2005	FY 2006
Baseline SAF Revenue	$10,533.5	$10,854.7	$11,236.7
Balance Sheet Adjustments	$82.0	($17.3)	($0.6)
Net SAF Estimates	$10,615.5	$10,837.4	$11,236.1
Adjustments to FY 2006 Base Year	($82.6)	$16.7	$0.0
Baseline Revenue on a FY 2006 Base	$10,532.9	$10,854.1	$11,236.1

School Aid Fund Revenue Adjustment Calculation for FY 2006

Sum of FY 2004 & FY 2005	$10,532.9	+	$10,854.1	=	$21,387.0
Sum of FY 2005 & FY 2006	$10,854.1	+	$11,236.1	=	$22,090.2

FY 2006 Revenue Adjustment Factor	**1.0329**

Note: Factor is calculated off a FY 2006 base year.

Revenue Detail

The estimated tax and revenue totals include the effects of all enacted tax changes except sales tax savings resulting from reductions in revenue sharing payments to local units. The revenue totals by tax are presented separately for GF-GP and for the SAF (See Tables 8 and 9). Tax totals for the income, sales, use, and tobacco taxes for all funds are also included (See Table 10).

Table 8

Administration General Fund General Purpose Revenue Detail

(millions)

	FY 2004		FY 2005		FY 2006	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
GF-GP Tax Amounts						
Income Tax	$3,977.7	0.4%	$4,017.4	1.0%	$4,116.9	2.5%
Sales	$102.2	60.3%	$112.4	10.0%	$114.8	2.1%
Use	$877.4	7.1%	$917.0	4.5%	$957.0	4.4%
Cigarette	$242.7	-16.1%	$117.0	-51.8%	$227.1	94.2%
Beer & Wine	$51.5	0.8%	$52.0	1.0%	$52.5	1.0%
Liquor Specific	$33.0	6.1%	$33.5	1.5%	$34.0	1.5%
Single Business Tax	$1,827.6	-0.8%	$1,880.7	2.9%	$1,903.8	1.2%
Insurance Co. Premium	$230.3	-0.3%	$229.3	-0.4%	$232.0	1.2%
Telephone & Telegraph	$101.3	-18.4%	$95.3	-5.9%	$79.3	-16.8%
Inheritance Estate	$75.5	-23.4%	$28.0	-62.9%	$5.0	-82.1%
Intangibles	$0.1	0.0%	$0.0	0.0%	$0.0	0.0%
Casino Wagering	$3.2	NA	$41.9	1209.4%	$42.5	0.0%
Horse Racing	$2.0	0.0%	$0.0	0.0%	$0.0	0.0%
Oil & Gas Severance	$57.1	19.2%	$67.0	17.3%	$60.0	-10.4%
GF-GP Other Taxes	$24.0	-54.6%	$28.5	18.8%	$28.0	-1.8%
Total GF-GP Taxes	$7,605.5	-0.1%	$7,620.0	0.2%	$7,852.8	3.1%
GF-GP Non-Tax Revenue						
Federal Aid	$66.1	40.0%	$35.0	-47.0%	$35.0	0.0%
From Local Agencies	$2.9	222.2%	$2.0	-31.0%	$2.0	0.0%
From Services	$17.8	109.4%	$18.0	1.1%	$18.0	0.0%
From Licenses & Permit	$55.2	226.6%	$54.0	-2.2%	$54.0	0.0%
Miscellaneous	$76.1	-23.9%	$113.2	48.8%	$124.5	10.0%
Short Term Note Int.	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Interfund Interest	($22.2)	66.9%	($73.0)	228.8%	($83.0)	13.7%
Liquor Purchase	$139.4	9.9%	$136.0	-2.4%	$132.0	-2.9%
Charitable Games	$12.2	8.9%	$11.5	-5.7%	$11.5	0.0%
Transfer From Escheats	$89.0	55.3%	$50.8	-42.9%	$27.8	-45.3%
Other Non Tax	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
Total Non Tax	$436.5	25.6%	$347.5	-20.4%	$321.8	-7.4%
Total GF-GP Revenue	$8,041.8	1.0%	$7,967.5	-0.9%	$8,174.7	2.6%

Table 9

Administration School Aid Fund Revenue Detail

	FY 2004		FY 2005		FY 2006	
	Amount	**Growth**	**Amount**	**Growth**	**Amount**	**Growth**
School Aid Fund						
Income Tax	$1,893.4	2.5%	$1,990.8	5.1%	$2,052.0	3.1%
Sales Tax	$4,716.7	0.8%	$4,828.7	2.4%	$5,036.0	4.3%
Use Tax	$439.1	7.0%	$458.6	4.4%	$478.5	4.4%
Liquor Excise Tax	$32.4	5.9%	$33.5	3.4%	$34.0	1.5%
Cigarette	$469.3	-0.5%	$452.6	-3.5%	$445.1	-1.7%
Other Tobacco	$16.0	-9.7%	$16.0	0.0%	$16.0	0.0%
State Ed Prop Tax	$1,824.5	-14.2%	$1,854.0	1.6%	$1,956.9	5.6%
Real Estate Transfer	$317.5	15.2%	$320.0	0.8%	$320.0	0.0%
Ind and Comm Facilities	$150.2	-6.8%	$133.5	-11.1%	$133.0	-0.4%
Casino (45% of 18%)	$95.8	5.4%	$97.1	1.4%	$98.4	1.3%
Commercial Forest	$2.8	0.0%	$2.8	0.0%	$2.8	0.0%
Other Spec Taxes	$13.0	10.2%	$12.0	-7.7%	$12.0	0.0%
Subtotal Taxes	$9,970.7	-1.6%	$10,199.5	2.3%	$10,584.7	3.8%
Lottery Transfer	$644.9	10.1%	$638.0	-1.1%	$651.3	2.1%
Total SAF Revenue	$10,615.5	-0.9%	$10,837.4	2.1%	$11,236.1	3.7%

Table 10

Administration Major Tax Totals

Major Tax Totals (Includes all Funds)						
Income Tax	$5,872.5	1.1%	$6,009.7	2.3%	$6,170.4	2.7%
Sales Tax	$6,473.5	0.8%	$6,630.5	2.4%	$6,915.0	4.3%
Use Tax	$1,316.5	7.0%	$1,375.6	4.5%	$1,435.5	4.4%
Cigarette and Tobacco	$993.3	11.5%	$1,159.2	16.7%	$1,140.5	-1.6%